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Dear CEO

### **Prudential Approach for IFPRU investment firms**

As you know, IFPRU investment firms are captured by our Prudential Sourcebook for Investment Firms (IFPRU).<sup>1</sup> The FCA has publicly stated that we will conduct our Supervisory Review and Evaluation Process (SREP) in line with the European Banking Authority (EBA)'s published guidelines addressed to competent authorities on common procedures and methodologies.<sup>2</sup> For additional information please see the implementation pages on our website.<sup>3</sup>

With the changes this entails we wanted to contact you to explain our existing approach and hence help you to prepare for our SREP. The SREP is our review of your Internal Capital Adequacy Assessment Process (ICAAP).

Although the UK voted to leave the European Union on 23 June 2016, the Capital Requirements Regulation (CRR) remains directly applicable until any changes are made, which will be a matter for Government and Parliament. Likewise, our IFPRU sourcebook that is derived from the Capital Requirements Directive also remains applicable. Firms must continue to abide by their obligations under UK law and EU law and continue with implementation plans.<sup>4</sup>

Your firm/group is required to carry out an ICAAP and have in place suitable policies, processes, systems and controls to manage risk and hold appropriate resources to meet the overall financial adequacy rule in IFPRU 2.2.1R (see IFPRU 2.2.7R).

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<sup>1</sup> This is part of the FCA's implementation of the CRDIV <https://www.handbook.fca.org.uk/handbook>

<sup>2</sup> See [www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+\(Guidelines+on+SREP+methodologies+and+processes\).pdf](http://www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+(Guidelines+on+SREP+methodologies+and+processes).pdf)

<sup>3</sup> See <https://www.the-fca.org.uk/firms/crd-iv>

<sup>4</sup> See FCA statement on European Union referendum result <http://www.fca.org.uk/news/european-union-referendum-result-statement>

The ICAAP should be a risk management tool used by the firm/group to inform business decisions; it should not be treated purely as a compliance exercise. As set out in IFPRU 2.2.16G, the ICAAP should be reviewed at least annually.

As part of our full SREP review, we will request your ICAAP document. You should ensure that the ICAAP is the responsibility of, and reported to, the firm's governing body, and forms an integral part of the firm/group's management process and decision-making culture. The level of detail provided in the document should be sufficient for the reader to gain a comprehensive understanding of the firm/group's ICAAP. It should be a stand-alone document and include, at least, the following:

- Details of the firm/group's business model and business plan including identification of the firms included in the prudential consolidation group
- Discussion of the firm/group's strategies, processes and systems to manage risk. You must demonstrate that these are comprehensive and proportionate to the nature, scale and complexity of your firm/group's activities and justify why you considered them to be so
- Governance arrangements and risk management tools, including the firm/group's overall risk appetite and tolerance, and any metrics used to monitor the risk appetite
- Assessments of the amounts, types and distribution of financial resources, own funds and internal capital that the firm/group considers adequate to cover the nature and level of the risks to which the firm/group is or might be exposed (overall Pillar 2 rule in IFPRU 2.2.7R). This should include an assessment for the relevant risks not covered by or not adequately covered by Pillar 1. For example, where operational risk may be one of the key risks your firm/group is primarily exposed to. When a risk is deemed immaterial a rationale must be provided
- Identification of the major sources of risk to the firm/group's ability to meet its liabilities as they fall due, while demonstrating compliance with all of, or the parts of, BIPRU 12 applicable to your firm/group
- Stress tests and scenario analysis undertaken in accordance with SYSC 20, and, where applicable, the General Stress and Scenario Testing Rule (IFPRU 2.2.36R). This is to assess how the firm/group's capital and own funds requirement would alter and what the reaction might be to a range of adverse scenarios, including operational and market events. A firm/group should also consider the impact of a severe economic or industry downturn on its future earnings, own funds and own funds requirements, taking into account its business plans. The downturn scenario should be focussed on forward-looking hypothetical events
- It would also be helpful for our review if you provide a breakdown of the Pillar 1 own funds requirement calculation

In our undertaking of SREP, we will take into account the nature, scale and complexity of your business. We will perform our SREP alongside reviews for other firms with similar business models and use peer analysis to ensure our approach is consistent across the sector.

Where a firm/group has not provided an adequate analysis of a particular risk that we consider important, we will use alternative methodologies to approximate the risk. As part of our SREP review we may also use data from COREP and FINREP. It is your firm/group's responsibility to ensure that these data are accurate.

We may also give your firm/group Individual Capital Guidance (ICG) as per IFPRU 2.3.11G. The ICG will advise the amount and quality of capital that your firm/group should hold at all times in order to meet the overall financial adequacy rule. This may include a risk management and governance scalar, where we have insufficient information to reach a conclusion and in order to capture unsighted and/or unquantified risks and as an incentive to help ensure corrective action is taken while providing protection for creditors in the meantime. We recognise that holding higher own funds may not be the most appropriate supervisory tool for all types of risks and weaknesses identified. In such cases we may use additional supervisory tools which will set out actions that we expect the firm/group to take in order to rectify weaknesses observed.

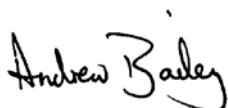
If your firm needs to carry out an ICAAP on a consolidated basis, please refer to IFPRU 2.2 on ICAAP.

We will publish "lessons learnt" from SREPs to share good practice and common errors observed. We expect to do this in 2017.

In parallel with this letter, the FCA is publishing a letter addressed to the Chair of the Board of Significant IFPRU firms to highlight the requirements on governance as specified in CRDIV. The aim is to inform them of some areas where we have found a narrow interpretation of the rules, so the issues can be addressed proactively as a result of the same.

We hope this is helpful. If you have any questions please email [firm.queries@fca.org.uk](mailto:firm.queries@fca.org.uk).

Yours faithfully,

A handwritten signature in black ink that reads "Andrew Bailey". The signature is written in a cursive, slightly stylized font.

**Andrew Bailey**  
**Chief Executive**